Severance Tax Direct Distribution Discussion

Objectives:

- To understand the current method of distributing severance and federal mineral lease revenues to local governments

- To identify problems and concerns about the current method of direct distribution

- To consider the options to current methods in order to make recommendations to the Interim Committee

The State Severance Tax Statute Creates A Framework for Distribution of these funds

39-29-101. Legislative declaration.

(1) The general assembly hereby finds and declares that, when nonrenewable natural resources are removed from the earth, the value of such resources to the state of Colorado is irretrievably lost. Therefore, it is the intent of the general assembly to recapture a portion of this lost wealth through a special excise tax, in addition to other business taxes, on the nonrenewable natural resources removed from the soil of this state and sold for private profit.

(2) The general assembly further finds and declares that the severance of nonrenewable resources provides a potential source of revenue to the state and its political subdivisions. Therefore, it is the intent of the general assembly to impose a tax on the process of severance in addition to other business taxes.

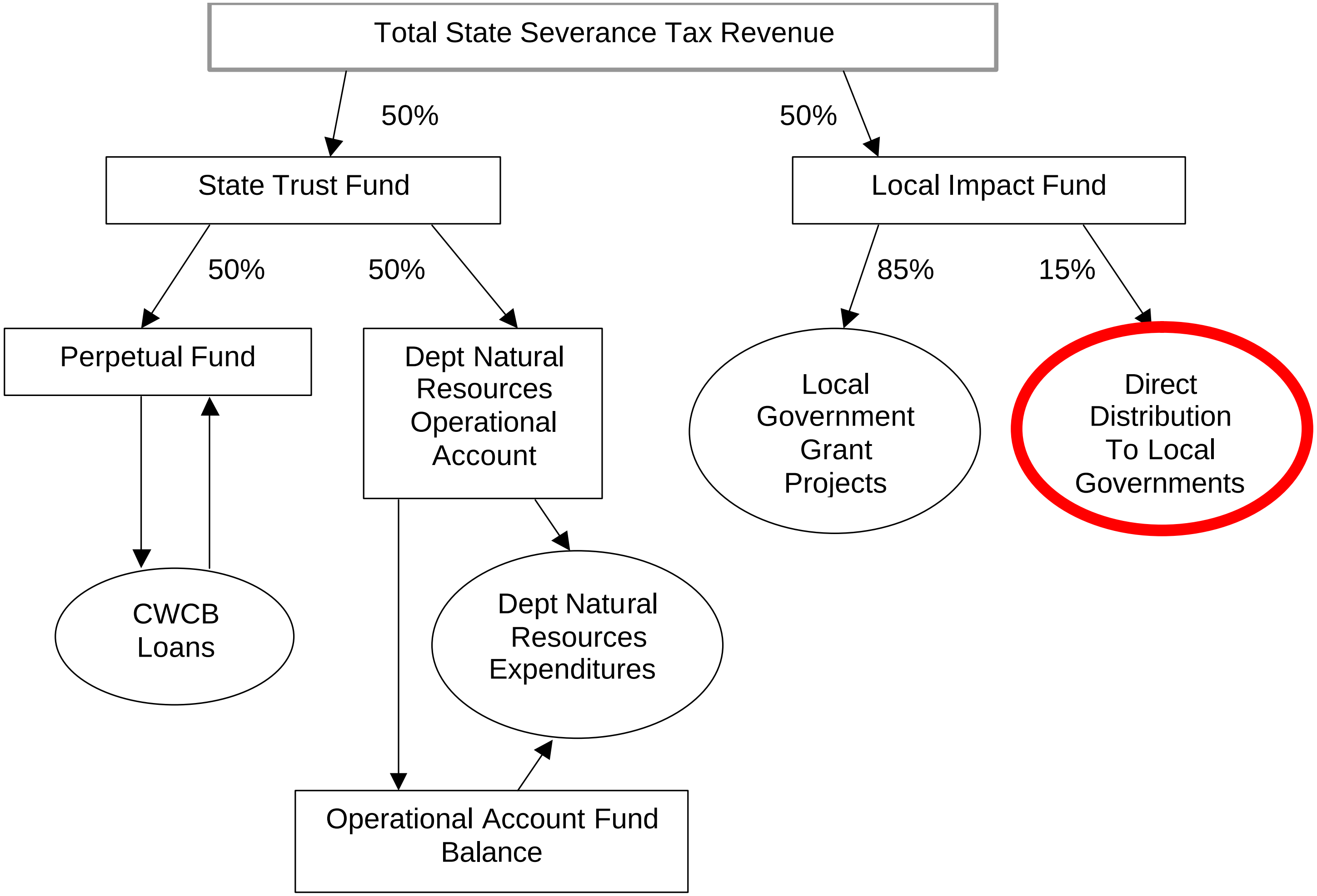
(3) It additionally is the intent of the general assembly that a portion of the revenues derived from such a severance tax be used by the state for public purposes, that a portion be held by the state in a perpetual trust fund, and that a portion be made available to local governments to offset the impact created by nonrenewable resource development.
Source: L. 77: Entire article added, p. 1844, § 1, effective January 1, 1978.

To provide local governments with funds to off-set the costs of mineral development impacts,

state statutes direct a part
- of the severance tax and
- state receipts from federal mineral leases

to provide for annual direct distribution payments
- to towns and counties
- based on the reported residence of the employees
- of mineral producers.

A graphical representation of the state distribution of severance tax revenue shows the part distributed directly to local governments on the basis of the reported residence of production-related employees of severance taxpayers.



Federal mineral lease revenues to the state are distributed in a complex "cascade" formula set in state statute,

which also has a direct distribution component.

FEDERAL MINERAL LEASING ACT

Sends revenue from the Naval Oil Shale Reserve to a special set aside in the US. Treasury
Returns 50% of rentals and royalties from federal lands in the state of origin.
- Directs that such funds be used by the states for planning, maintenance of public facilities and services in areas of the state Socially and economically impacted by mineral development.

COLORADO MINERAL LEASING FUND

-Colorado statute (CRS 34-63-102) directs that in the distribution of these funds priority shall be given to school districts and political sub - divisions socially or economically impacted by the development or construction and processing of the federal minerals.
- Distributes oil shale lease revenue to a trust fund in the legislature,
- Distributes all other amounts originating in each county as reported by the Federal government under the following "cascade" type of formula:

OIL SHALE TRUST FUND

FIRST CUT:

50%
To the county area of origin
up to $200,000

25%
To the State Public School Fund

15%
To the Department of Local Affairs

10%
To the Water Conservation Board

SPILLOVER
All funds from counties whose 50% share went over $200,000

$ 10.7 M FILL-IN
State Public School Fund gets all the spillover up to $ 10.7 million

BALANCE
Funds in the spillover in excess of $10.7 million

SECOND CUT
All county areas who contributes to the SPILLOVER gets what remains of their 50% in the BALANCE up to a total limit of $1.2 million per county area. These funds are distributed to counties school districts and towns
As follows

SCHOOL DISTRICTS
get at least 25% of each county's total distribution

TOWNS
Get at least 37.5% of each county area total distribution above $250,000

COUNTY
Gets the residual

OVERFLOW
All funds from counties whose 50% share went over $ 1,200,000

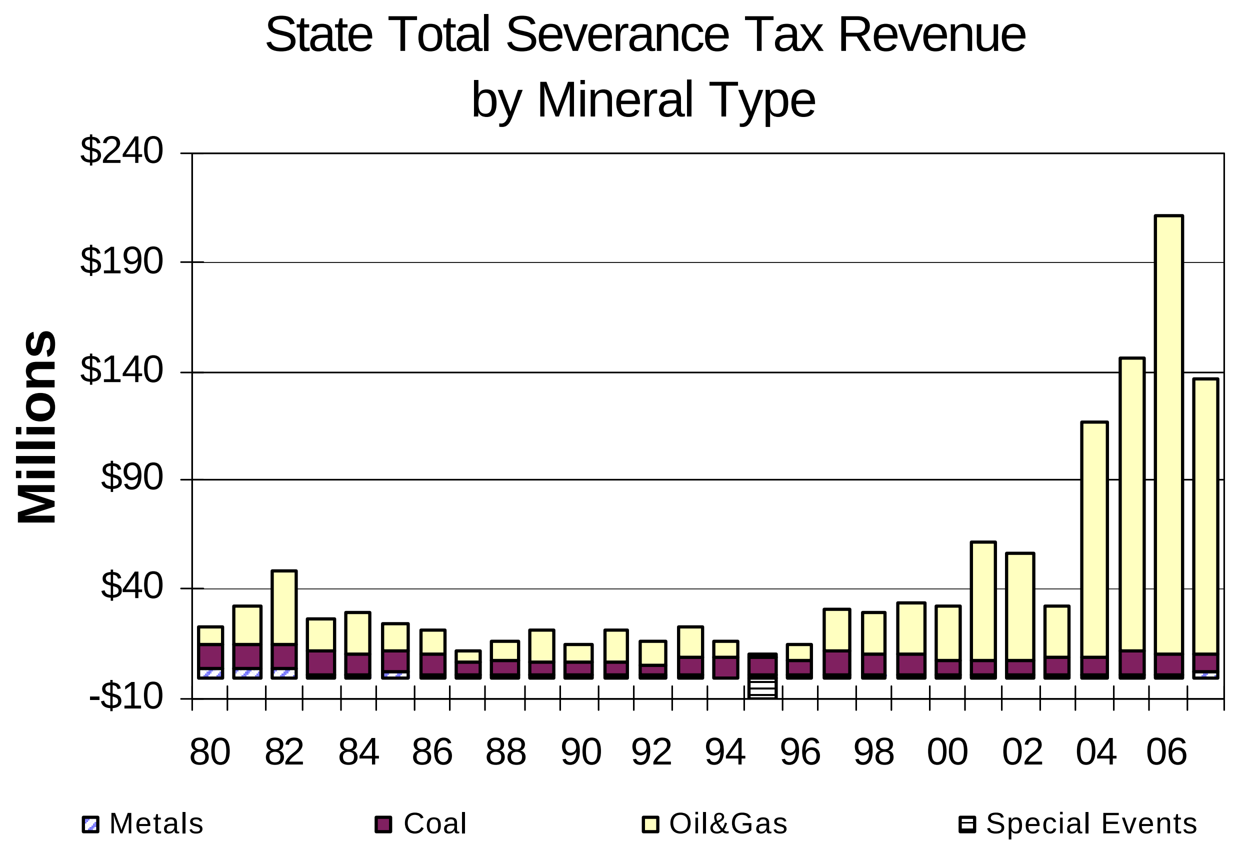
THE OVERFLOW SPLIT

50% of the overflow goes to the State Public School Fund

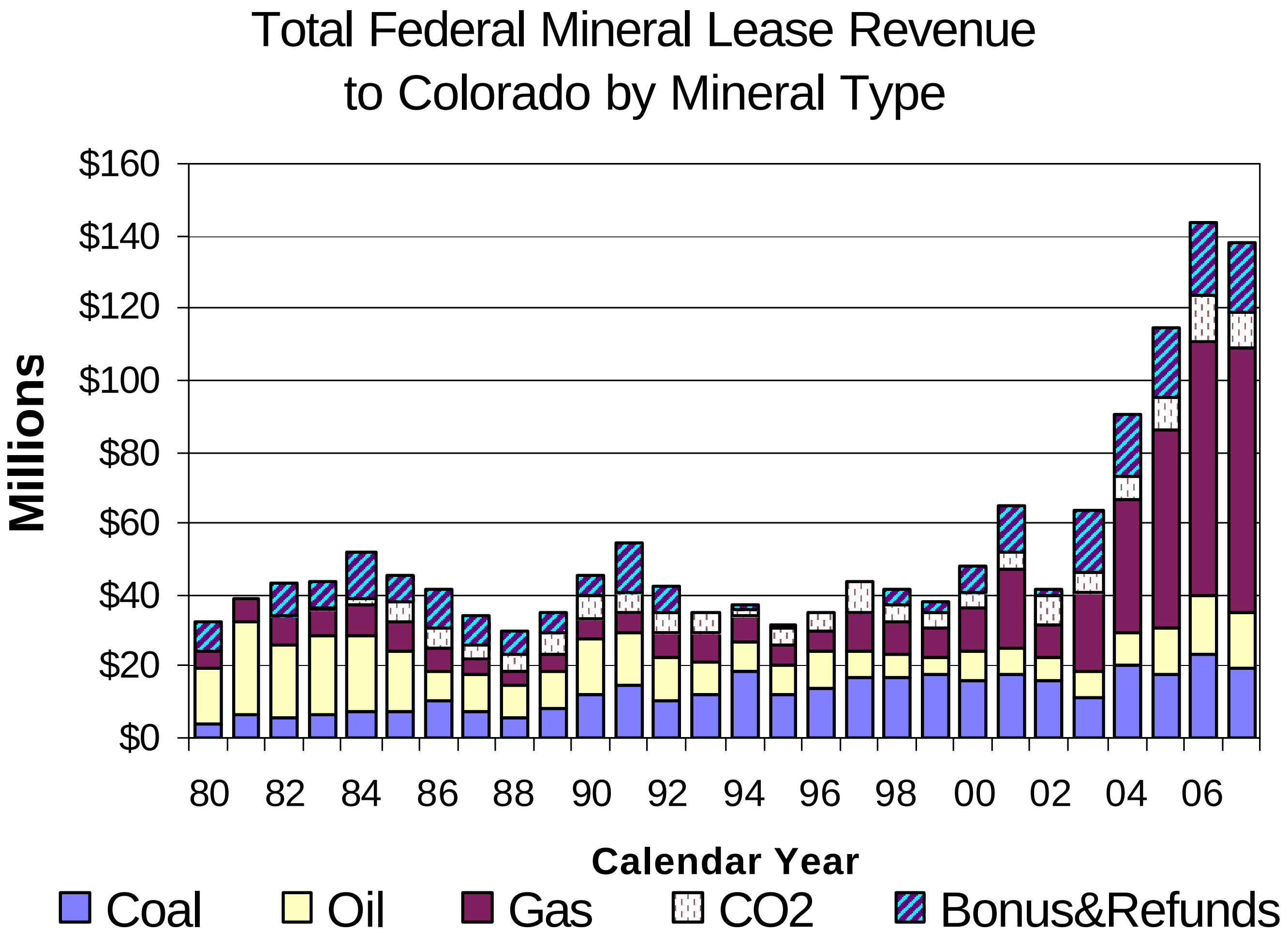
50% of the overflow goes to the Department of Local Affairs

DIRECT DISTRIBUTION
25% of the DLA 50% overflow is distributed to cities and counties on the basis of employee residence reports.

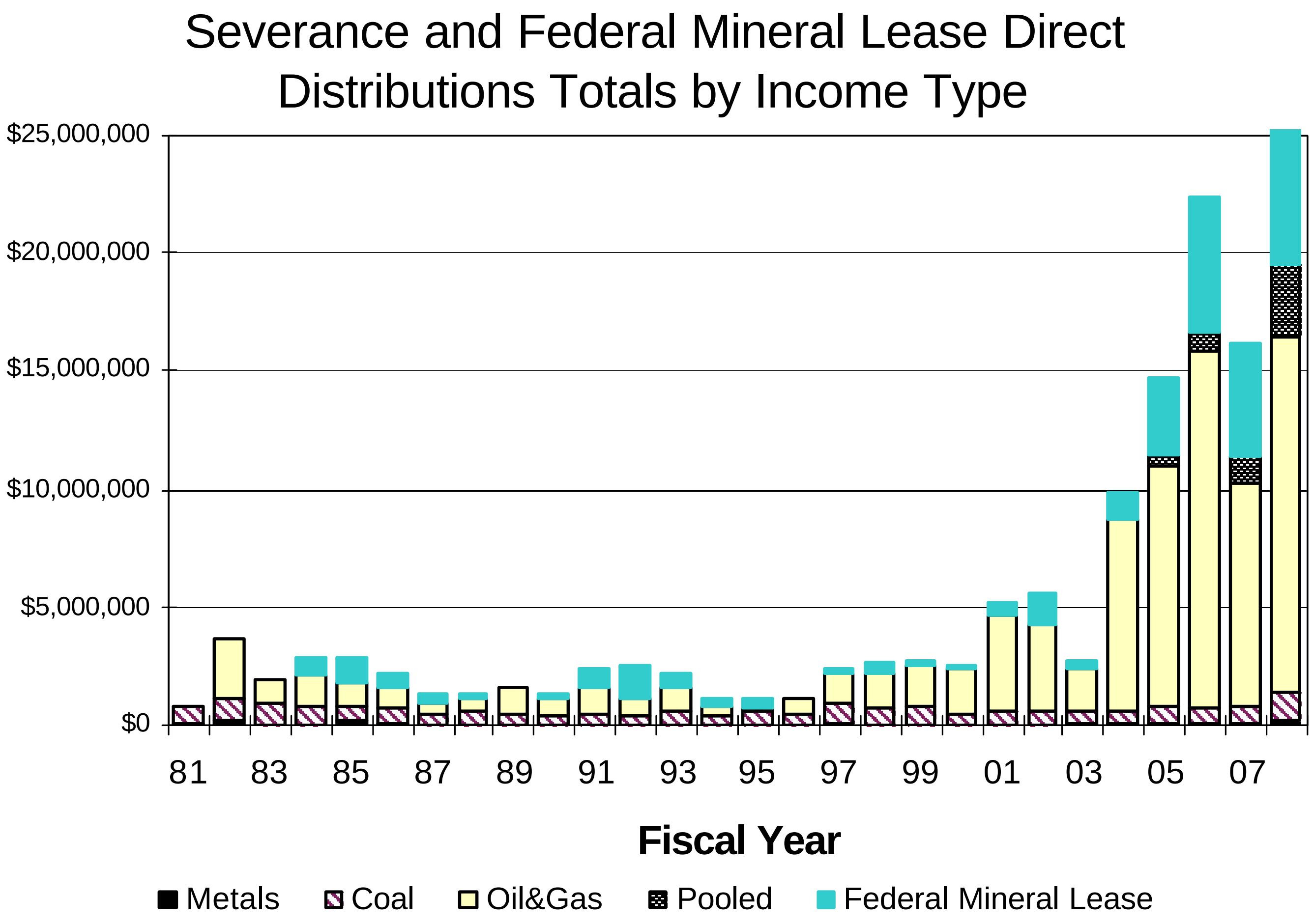
Severance tax revenue to the state has been highly variable so the direct distribution to local governments has been unpredictable



Federal Mineral Lease receipts to the state have cycled with mineral values.

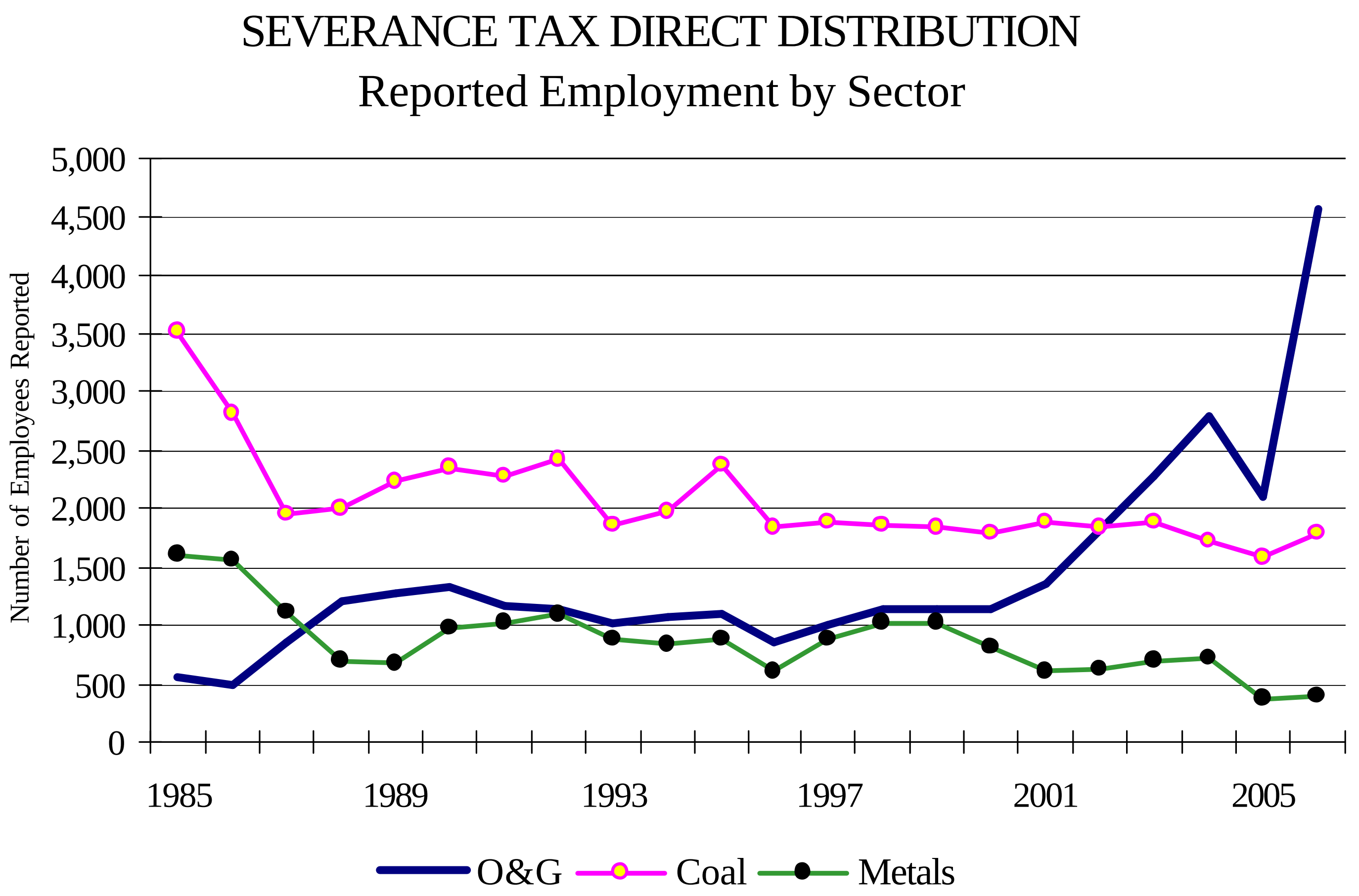


As a result, the mineral impact direct distribution amounts have ranged widely, and we forecast 2008

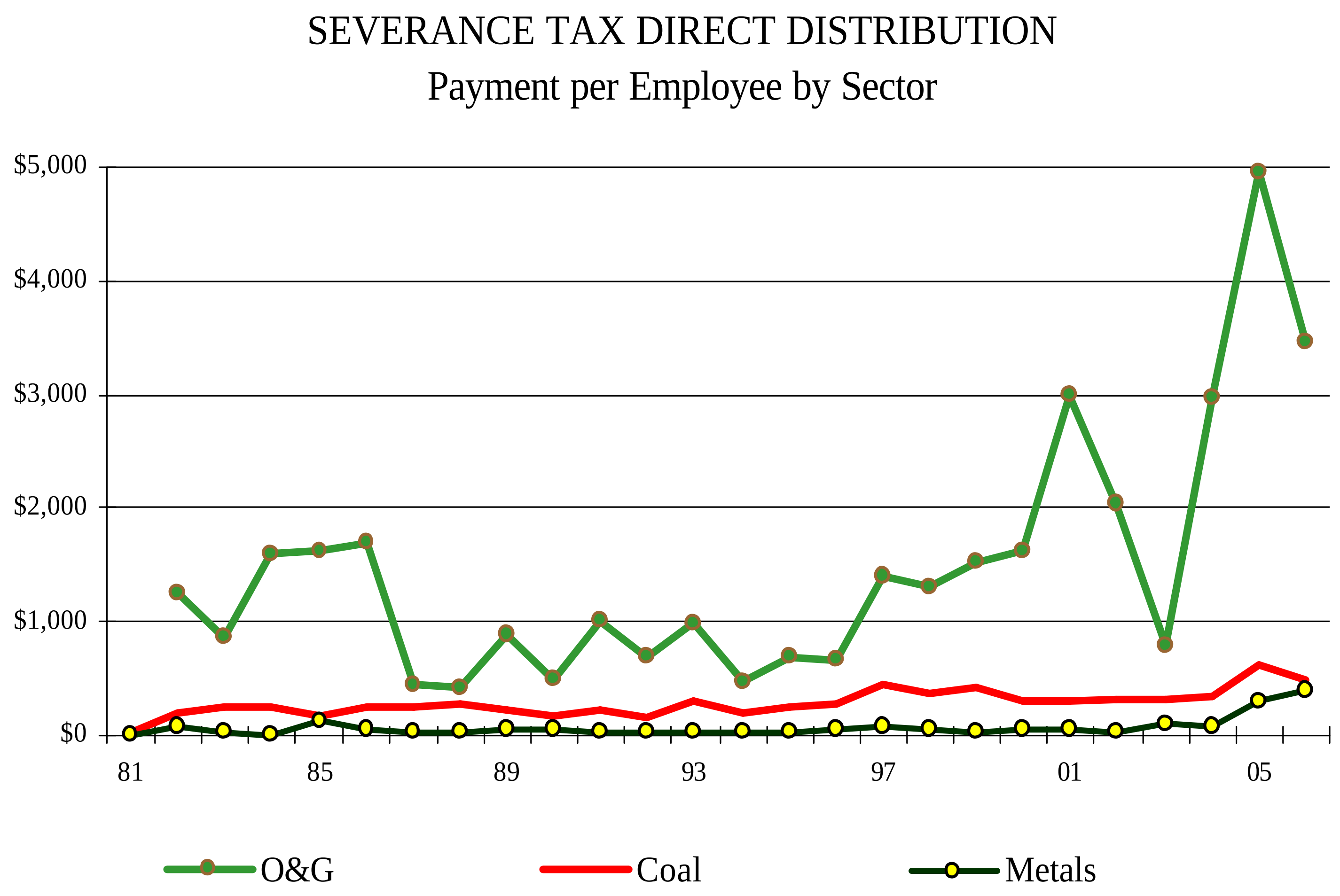


The reported employment of severance taxpayers has increased dramatically in the last few years.

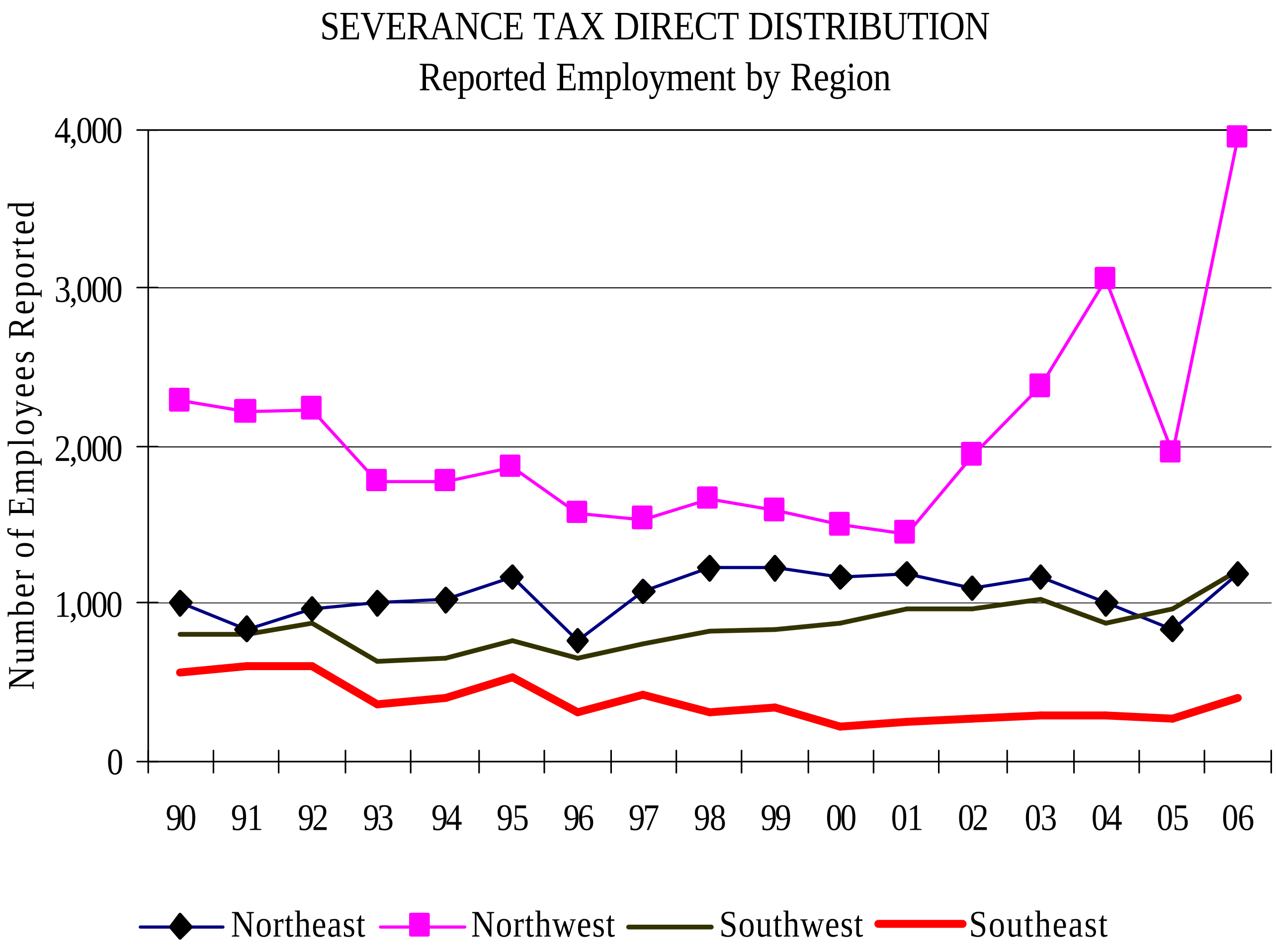
Each counted employee is very valuable to every county or town that can claim a worker under the statute



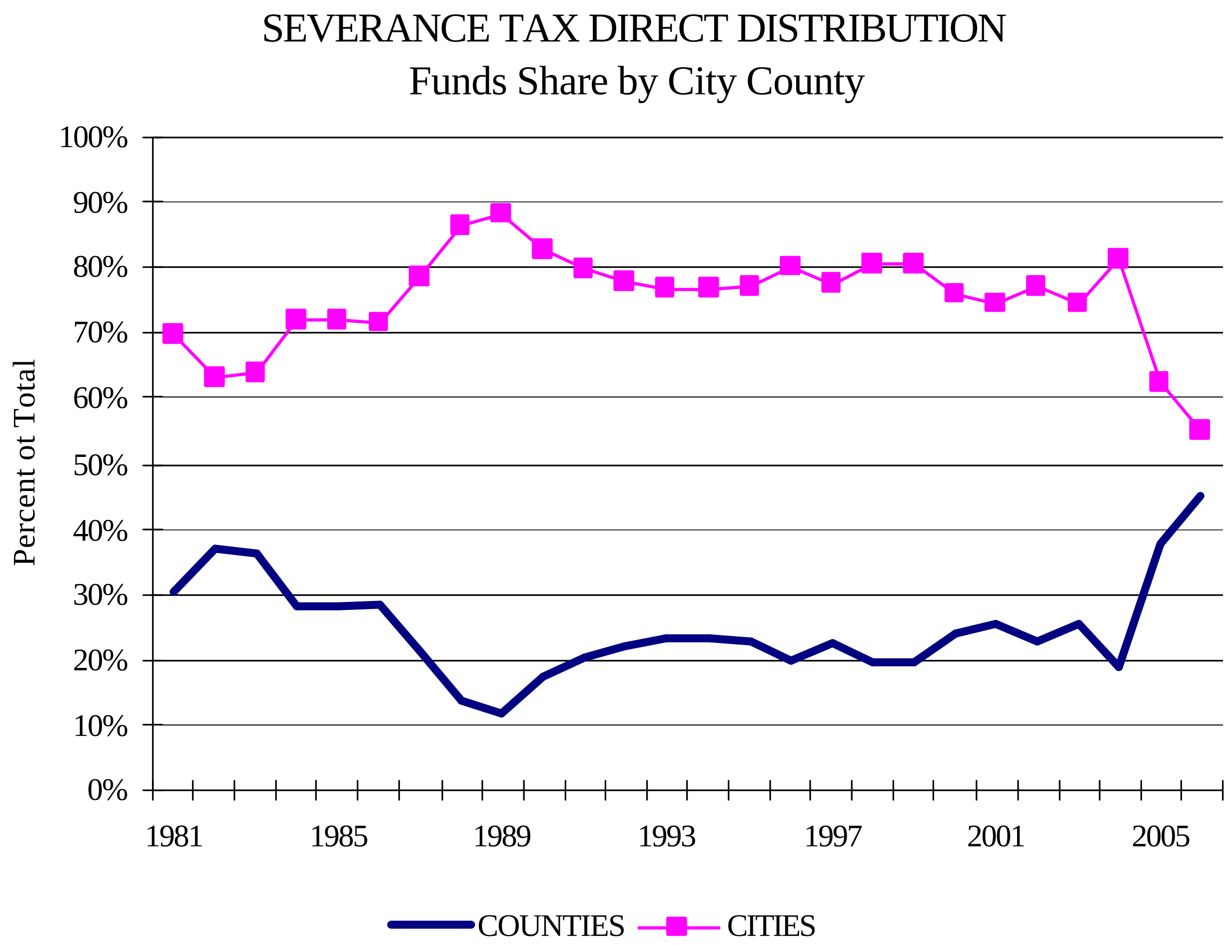
The payment per reported employee has varied widely since 1981 but the trend is upward



The Northwest quadrant of the state is the only one showing significant increases in reported employees.



The share of payments to towns or counties has fluctuated.



Additional Observations about the Severance Tax Direct Distribution

Under the statutory specifications the collection of the severance producer employee residence data has been reliable and trouble free for the stable coal and metal employers. Coal and metal employee counts are easier to specify than gas and oil employee counts

The collection of the severance producer employee residence data for the oil and gas industry has been a problem for both the producers and the state agencies.

Recent trends in the distribution of direct distribution of severance tax revenues show that the interpretation of the employee residence reporting statute by gas and oil producers differs throughout the state resulting in a significant shift in payments towards Mesa and Garfield counties, causing other counties to be concerned about loss of revenue.

Challenging problems have arisen

- It is hard to determine which producers must make a report. For instance, should **sub-contractors** make reports?

- Contractors who work for multiple producers create a significant problem with **double counting**.

- It is hard to determine which employees should be reported. For instance, what **job titles** should be counted?

- It is difficult to determine the specific local government that should receive the payment. Each employee may be "claimed" by a **county or a municipality**, but not both.

State agency, local government and industry representatives have struggled to overcome these problems by forming

- an early Task Force

- the on going Oversight Committee, and,

- adding data to the employee residence report form:
  - **- occupation**
  - **- addresses**
  - **- federal mineral lease status**

The Statutes

The Colorado statute for the Federal Mineral Lease Direct Distribution makes only a general reference as to the method of calculation

34-63-102. Creation of mineral leasing fund - distribution - advisory committee.

(3)(b)(III) An amount equal to twenty-five percent of the balance paid to the local government mineral impact fund pursuant to subparagraph (II) of this paragraph (b) shall be distributed annually to each county, in whose unincorporated area employees of a mine or related facility from which such money is derived reside, in the same proportion that the number of such employees bears to the total number of employees of such mines and related facilities who reside in the state and to each municipality, in which employees of such facilities reside, in the same proportion that the number thereof bears to the total number of employees of such mines and related facilities who reside in the state.

The parties have always interpreted this to refer to the severance taxpayer employee residence reporting process in C.R.S.39-29-110

The severance tax statute specifies the data reporting process for making the direct distribution.

39-29-110. Local government severance tax fund
(1)(a)(I) There is hereby created in the department of local affairs a local government severance tax fund.

(1)(c) Except as otherwise provided in paragraph (c.5) of this subsection (1), an amount equal to fifteen percent of said gross receipts credited to the fund shall be distributed to counties or municipalities on the basis of the proportion of employees of the mine or related facility or crude oil, natural gas, or oil and gas operation who reside in any such county's unincorporated area or in any such municipality to the total number of employees of the mine or related facility or crude oil, natural gas, or oil and gas operation. Such distribution shall be made on the basis of the report required in paragraph (d) of this subsection (1).

The severance percentage for direct distribution was increased to 30% by HB07-1139, to take effect with the August 2008 distribution.

The severance tax statute provides specific instructions for reporting:

- The statute specifies which producers must make a report.

- The statute specifies which employees should be reported.

- The statute specifies to report the city or county in which the employees reside.

- The statute specifies when the payments should be made.

The first specification is “who” should submit an employee residence report:

39-29-110(1)(d)(I) Ninety days prior to the end of each fiscal year, the executive director of the department of revenue shall send every producer who is subject to the severance tax and whose payment is subject to the distribution formula provided in this subsection (1) a form on which the producer shall submit a report to the department of revenue.

39-29-110 (1)(d)(II)(A) For purposes of this subsection (1), a "producer of crude oil, natural gas, or oil and gas" means any person who files a crude oil, natural gas, or oil and gas production report with the oil and gas conservation commission pursuant to article 60 of title 34, C.R.S. A producer shall include a producer-operator or a unit operator.

Later in the same section of statute:

Any producer not liable for severance tax under this section shall not be required to submit a report under this subsection (1).

However, in the taxation sections of statute discussing exemptions from taxation it states:

39-29-105(1)(b) Nothing in this paragraph (b) shall exempt a producer of oil and gas from submitting a production employee report as required by section 39-29-110(1)(d)(I).

So, with this statutory language, many producers who do not pay severance tax are required to submit an employee residence report, often with zero qualifying employees.

The second specification is "what" should be reported in the employee residence report.

39-29-110 (1)(d)(I) . . . the producer shall submit a report indicating the following:
- The name and address of the producer, the name of the mine, related facility, or operation, the names of the municipalities or counties in which its employees maintain their actual residences as given by the employees, giving the number of employees for each such municipality or unincorporated area of each such county, and, the total number of employees of the mine or related facility or crude oil, natural gas, or oil and gas operation.

The statute goes on to further clarify that:

39-29-110 (1)(d)(II)(B) For purposes of this paragraph (d), an "employee of a crude oil, natural gas, or oil and gas operation" means any individual who is employed and compensated on a full-time basis by the producer of crude oil, natural gas, or oil and gas, as defined in sub-subparagraph (A) of this subparagraph (II), for the purposes of extracting such crude oil, natural gas, or oil and gas out of the ground and at point of first sale. Such employee may include any individual who is employed by any company or person who contracts with such producer for purposes of extracting such crude oil, natural gas, or oil and gas out of the ground and at point of first sale. "Individual who is employed on a full-time basis" means an employee who has worked for the producer or contractor during the six-month period next preceding the last day of the annual reporting period. "Employee" does not mean any employee of any exploration or drilling crew, any employee of any well service company, or any other contractor or person who may work in any such operation on a periodic or temporary basis and who is employed by companies or entities other than the producer.

The last specification is “when” the direct distribution payments should be made.

39-29-110 (1)(d)(I) Moneys distributed from the local government severance tax fund pursuant to paragraph (c) of this subsection (1) shall be distributed no later than August 31 of each year.

The data checking of the employee reports has been arduous.

One of hundreds of edit pages:

July 6, 2007 — **Taxpayers with Duplicate Employee Addresses 2007** — solese

willow creek apts — 10 units w/ 30 rooms — can't differentiate without Apt #'s

Job Title	Emp #	Taxpayer	Master Taxpayer
and Gas			
1230 W Battlement, Garfield County, Garfield County			
Laborer	1	Occidental Oil & Gas Corp (Oxy USA)	
Office Assistant	1	Occidental Oil & Gas Corp (Oxy USA) keep	
1230 W Battlement, Town of Parachute, Garfield County			
Rig Hand	2	Loed Energy Services	Encana Oil & Gas Usa, Inc.
1230 W Battlement Parkway, Garfield County, Garfield County			
Driller	1	COZ Rathole	Williams Production Rmt Co. (Parachute)
Driller	1	Helmerich & Payne	Williams Production Rmt Co. (Parachute)
Field Admin	1	Williams Production Rmt Co. (Parachute)	
Field Hand	1	COZ Rathole	Williams Production Rmt Co. (Parachute)
Floor Hand	2	Two In The Loop	Williams Production Rmt Co. (Parachute)
Land Administrator	1	Williams Production Rmt Co. (Parachute)	
Operator	2	Williams Production Rmt Co. (Parachute)	
Pusher	1	Two In The Loop	Williams Production Rmt Co. (Parachute)
Rig Operator	1	Speedy Heavy Hauling	Encana Oil & Gas Usa, Inc.
Technician	1	Williams Production Rmt Co. (Parachute)	
1230 W Battlement Parkway, Town of Parachute, Garfield County			
Fisherman	1	Monument Well Service	Williams Production Rmt Co. (Parachute)
Operator	1	Weatherford Testing Services	Encana Oil & Gas Usa, Inc.
Supervisor	1	Maverick Stimulation Co	Encana Oil & Gas Usa, Inc.
Supervisor	5	Weatherford Testing Services	Encana Oil & Gas Usa, Inc.
1230 W Battlement Pkwy, Garfield County, Garfield County			
Laborer	2	Advanced Oilfield Service	Encana Oil & Gas Usa, Inc.
Maintenance Operator	1	CEO Operating Inc	Encana Oil & Gas Usa, Inc.
Operator	2	Flint Energy	Encana Oil & Gas Usa, Inc.
Swamper	1	Badger Daylighting/Western CO	Encana Oil & Gas Usa, Inc.
1239 Blossom Rd, City of Woodland Park, Teller County			
Equipment Operator	1	BJ Chemical Services	Encana Oil & Gas Usa, Inc.
~~Equipment Operator~~	~~1~~	~~Occidental Oil & Gas Corp (Oxy USA)~~	dup ✓
124 Daniel #B, City of Rifle, Garfield County			
Truck Driver	1	Down Valley Septic	Encana Oil & Gas Usa, Inc.
~~Truck Driver~~	~~1~~	~~Occidental Oil & Gas Corp (Oxy USA)~~	dup ✓
125 Darius, Town of Rangely, Rio Blanco County			
Laborer	1	W.C. Striegel, Inc	Williams Production Rmt Co. (Parachute)
Truck Driver	1	Occidental Oil & Gas Corp (Oxy USA)	

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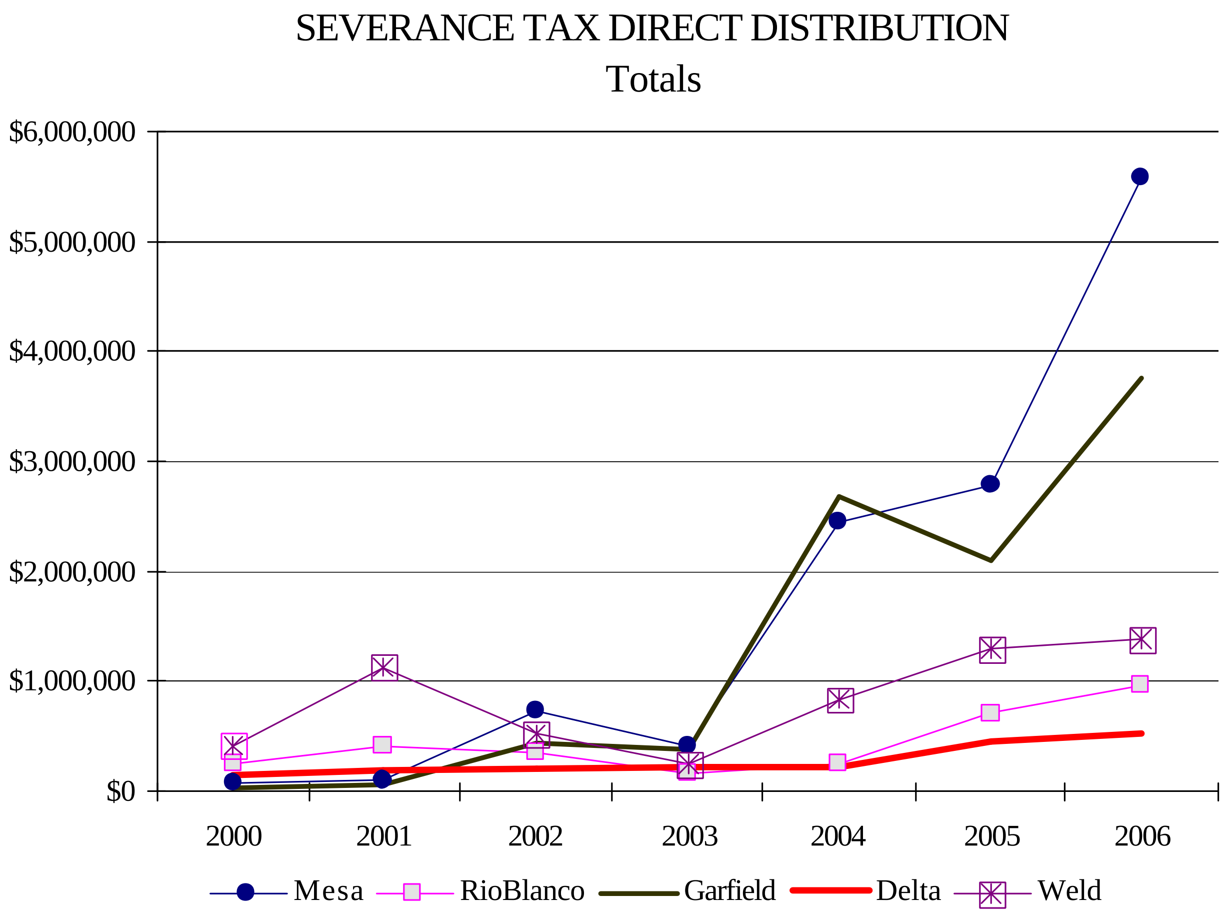
Summary of Status Quo with Direct Distribution

- The Direct Distribution of revenues to local governments help address impacts of the industry

- The employee count method is difficult to administer

- The employee count method of recognizing community impacts works well for some local governments but not for others. Compare Rio Blanco County with Delta or Mesa counties.

There are significant differences in payments totals in various counties with mineral production.



Additional issues that have arisen in recent years with the direct distributions process:

- The lack of inclusion of contract employees in the coal and metals mines employee reports.

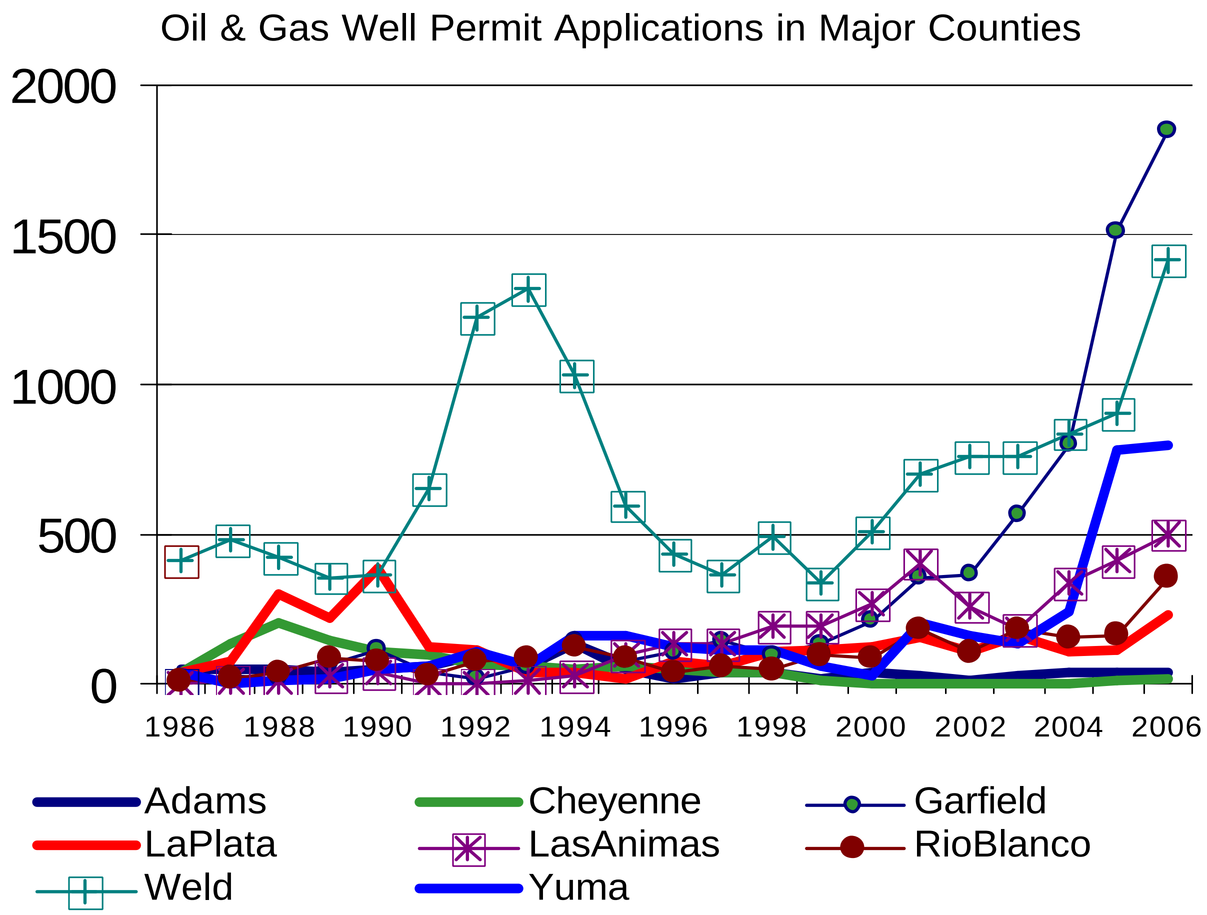
- The wide difference in payments per employee for oil and gas as compared to coal and metals.

Many have suggested alternative metrics that could be used for the oil and gas direct distribution.

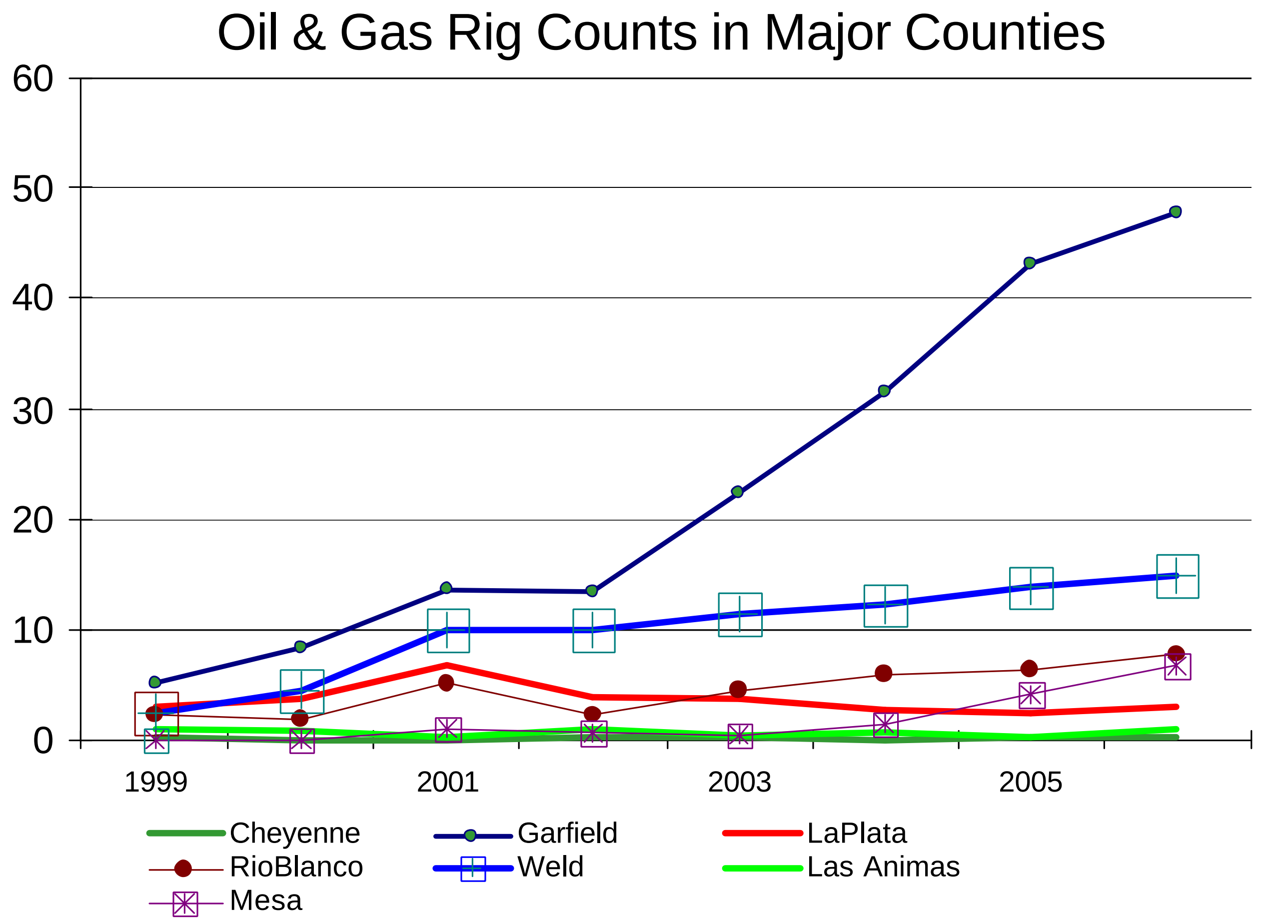
- **Oil and gas drilling permits.**
- **Oil and gas rig counts**
- **Oil and gas production**

Each reflects a different phase in the life cycle of mineral projects and their impacts on local governments.

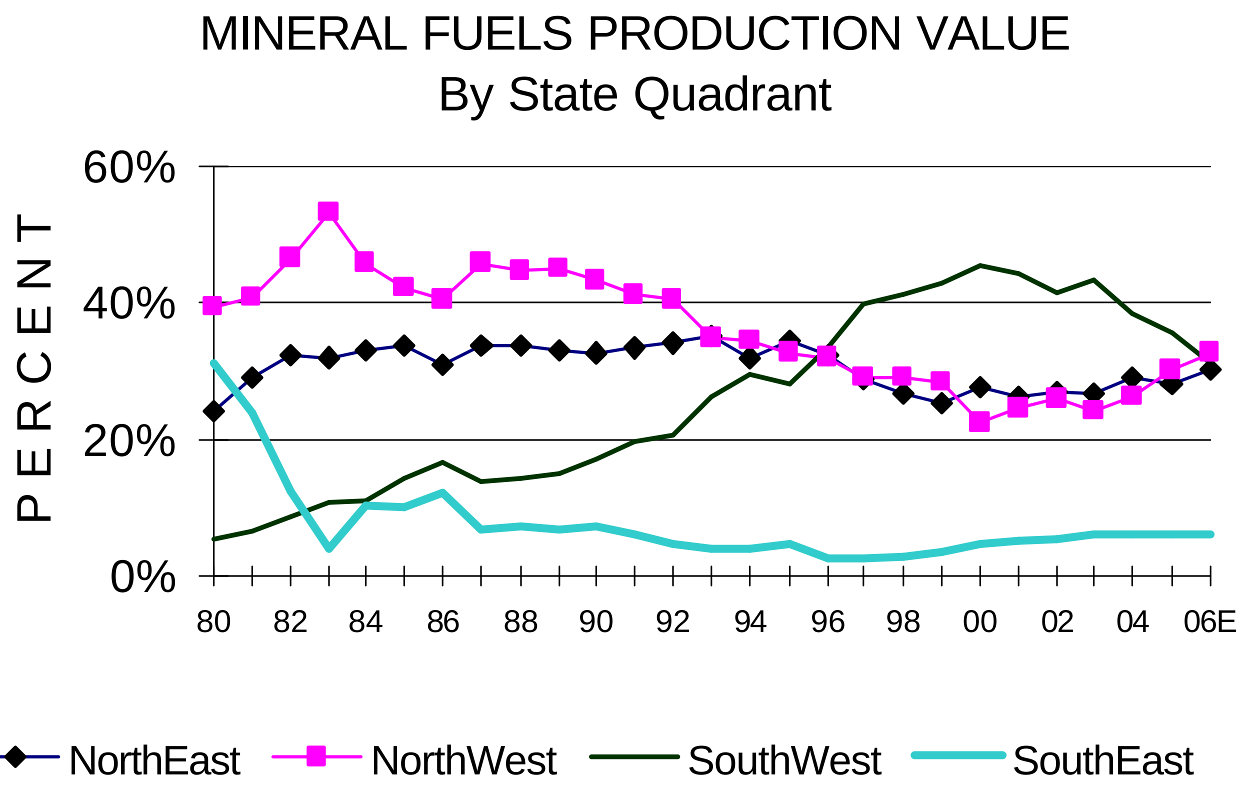
Oil and gas drilling permits applications to the COGCC would require a secondary variable to calculate payments to towns



Drilling rig counts are a commercial service, not a regulated data variable.

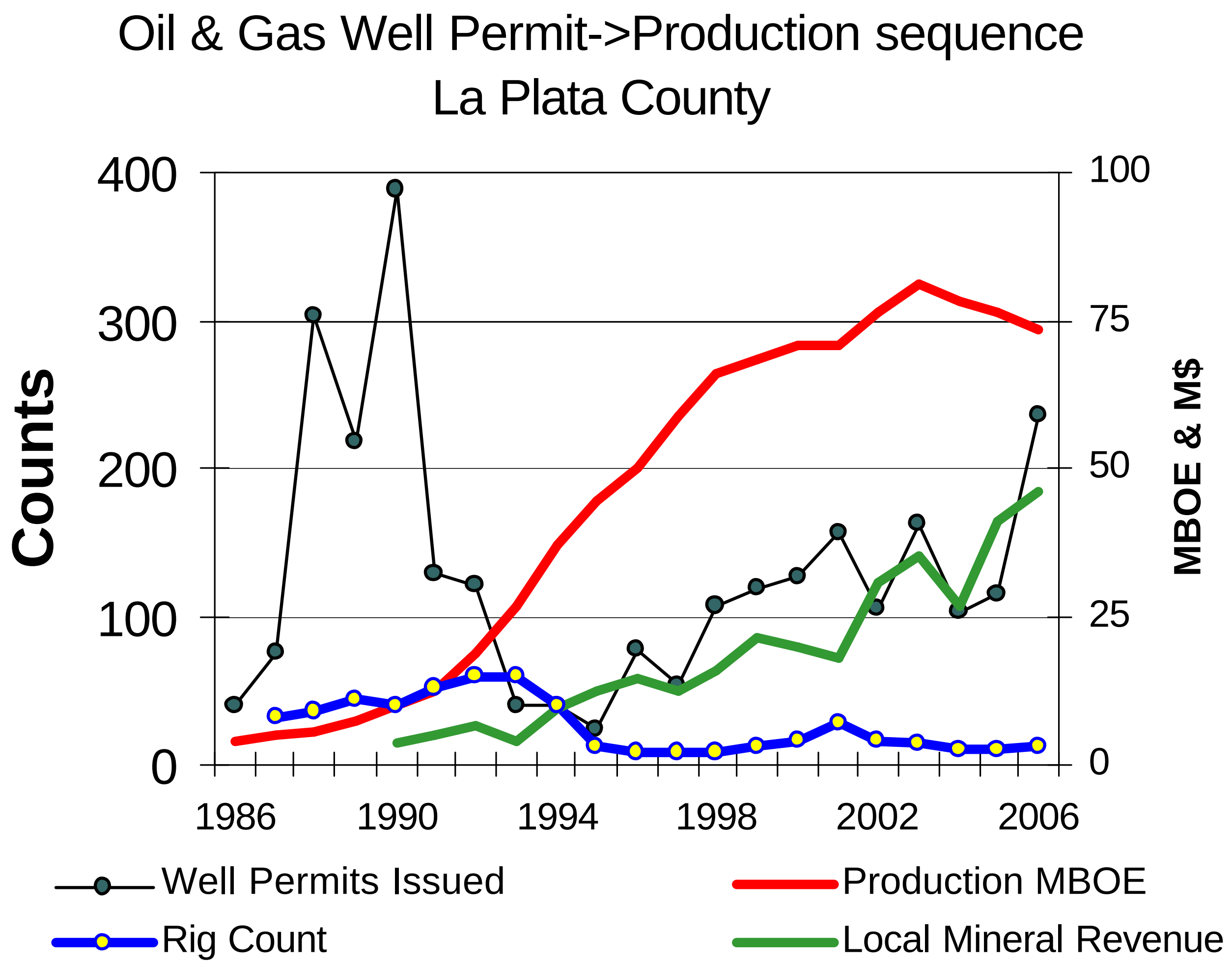


Production can be measured in many ways. The data would lag many measures of impact.



No single metric can cover the whole range of local government impacts in the life cycle of mineral projects from speculative planning through heavy lifting and on to the post project transitions.

The sequence of impact varies from county to county.



The creation of a new metric on which to distribute these funds must consider three criteria:

- Revenue is provided when the local government need financial impact assistance.

- Revenue is provided where local government fiscal impacts occur.

- Ease of administration